

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 05-0364
Use Tax for 2003

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ISSUE

Use Tax—Rental and lease of aircraft

Authority: IC 6-8.1-5-1(b); IC 6-2.5-3-2(b); IC 6-6-6.5-2; IC 6-2.5-5-8(b); Gregory v. Helvering, 293 U.S. 465 (1935); Horn v. Commissioner, 968 F.2d 1229 (D.C. Cir. 1992); Cambria Iron Co., v. Union Trust Co., 55 N.E. 745 (Ind. 1899); Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); *Black's Law Dictionary*, Seventh Edition.

Taxpayer protests the assessment of sales and use tax on an aircraft it asserts is rented and leased.

STATEMENT OF FACTS

Taxpayer is a for-profit Indiana S-corporation. In November 2003, Taxpayer purchased an aircraft and submitted its Application for Aircraft Registration, as required by law. On the application, Taxpayer claimed an exemption from sales and use tax on the purchase, asserting "Rental or Lease to others." The Department requested documentation from Taxpayer to substantiate the exemption. The Department determined that the aircraft was not being used for rental or lease and assessed use tax. Taxpayer protested and a hearing was held.

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b).

IC 6-2.5-3-2(b) imposes use tax on the storage, use, or consumption of an aircraft if the aircraft is acquired in an isolated or occasional sale and is required to be registered by the State of Indiana. Because Taxpayer is an Indiana corporation with an aircraft based within Indiana, it was required to register the aircraft with the State. *See* IC 6-6-6.5-2. Taxpayer promptly registered the aircraft. On the registration form, Taxpayer claimed exemption from sales and use tax, asserting rental or lease to others, as provided by IC 6-2.5-5-8(b).

The Department requested documentation to substantiate the claim for exemption. Taxpayer provided copies of leases and a copy of the aircraft insurance. The leases all stated:

[Taxpayer] will maintain an insurance policy for liability and physical damage on the Aircraft.
[Taxpayer] will ensure that Renter is listed as a named insured under such insurance policy.

An examination of Taxpayer's insurance policy on the aircraft reveals under Item 4 that the aircraft will be used only for non-commercial use. The policy defines "non-commercial" to mean:

private pleasure and business use, excluding any use for hire, money or any form of reward or compensation. Being reimbursed for or sharing the direct expenses of a **flight** if the sum of these expenses does not result in a profit to **you** or anyone is not excluded. [Bold original]

The definition of "insured" within the policy, states in relevant part:

But excluded as an **insured** is any:

...
(b) person or organization renting **your aircraft**

...
[Bold original]

Since the rental agreement states that Taxpayer will ensure that the renter is listed as a named insured under Taxpayer's insurance policy, the agreements for use tax purposes do not establish a qualified exemption for rental or lease to others.

Taxpayer is a for-profit corporation. However, the rental rate set by Taxpayer is significantly below the market rate to rent comparable aircraft. While the Department cannot establish at what rate a taxpayer should rent an aircraft, the Department can use that rate as indicia as to whether Taxpayer has a genuine motive to rent the aircraft for profit to others or whether Taxpayer is using the exemption to avoid paying sales and use tax on the purchase of the aircraft.

The past and present shareholders of Taxpayer corporation are [DT], [SM], [DP], [MS], [GB], [DD], and [FK]. Of the four aircraft rental agreements submitted to the Department by Taxpayer to support its claim for a tax exemption, all four of the executed agreements were between Taxpayer and its shareholders [DT], [SM], [DD], and [FK] as individuals. Taxpayer is not engaged in renting and leasing to others; this is a cost-sharing arrangement.

The lease agreements between Taxpayer and several of its shareholders as individuals fall squarely within the doctrine of sham transaction. The sham transaction doctrine is well established in state and federal tax jurisprudence. In Gregory v. Helvering, 293 U.S. 465, 469 (1935), the United States Supreme Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and to hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose. *Id.* at 470. Transactions invalidated by the sham transaction doctrine are those motivated by nothing more than the taxpayer's desire to secure the attached tax benefit but are devoid of any economic substance. See Horn v. Commissioner, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992).

The purchase of the aircraft by Taxpayer triggered sales and use tax. The individual shareholders who executed agreements with Taxpayer were able to secure the use of an aircraft for themselves without having to pay \$18,300 of sales and use tax at the time of the purchase. By setting the rental rate substantially below market rate, the individuals who desire to use the aircraft pay only a nominal sales tax when they "rent" the aircraft to themselves. Because renters are also shareholders, the money paid to Taxpayer S-corporation is passed back through to the shareholders. The net result is a wash transaction, and the shareholders, by way of the S-corporation, have avoided paying the upfront sales and use tax due on the purchase of the aircraft.

The shareholders have structured the "rental" transactions to secure the benefits of an exemption—but have not assumed the associated burdens. The Indiana Supreme Court has stated that a party cannot have the benefits without the burdens. See Cambria Iron Co., v. Union Trust Co., 55 N.E. 745, 749 (Ind. 1899). The Indiana Supreme Court has stated:

It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption.

Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

The relationship between Taxpayer and its "renters" is interfamilial. These agreements are not arms-length transactions with others. IC 6-2.5-5-8(b) grants a sales tax exemption if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business. *Black's Law Dictionary*, Seventh Edition, defines business as "a commercial enterprise carried on for profit; a particular occupation or employment habitually engaged in for livelihood or gain." Taxpayer purports to operate as a business, but does not have a profit motive. The Department determined that Taxpayer is not engaged in rental or leasing for the purposes of the sales and use tax exemption statutes.

FINDING

For the reasons stated above, the Department denied Taxpayer's protest.